**REPORT OF**
**FINANCIAL EXAMINATION**

# LINCOLN COUNTY FARMERS MUTUAL

# INSURANCE

**AS OF**
**DECEMBER 31, 2002**

**STATE OF MISSOURI**
**DEPARTMENT OF INSURANCE**
**JEFFERSON CITY, MISSOURI**

**TABLE OF CONTENTS**

Troy, Missouri

Honorable Scott B. Lakin, Director
Missouri Department of Insurance
301 West High Street, Room 530
Jefferson City, Missouri 65101

Sir:

In accordance with your examination warrant, a full-scope examination has been made of the records, affairs and financial condition of

**LINCOLN COUNTY FARMERS MUTUAL INSURANCE**

hereinafter referred to as such, or as the "Company". The Company's home office and principal place of business is located at 320 Main Street, Troy, Missouri, telephone number (636) 528-8242. This examination began on November 6, 2003, and was concluded on November 7, 2003, and is respectfully submitted.

## SCOPE OF EXAMINATION

**Period Covered**

The prior full-scope examination of the Company was made as of December 31, 1997, and was conducted by examiners from the State of Missouri. The current full-scope examination covers the period from January 1, 1998, through December 31, 2002, and was conducted by examiners from the Missouri Department of Insurance.

This examination also included material transactions and/or events occurring subsequent to the examination date, which are noted in this report.

**Procedures**

This examination was conducted using the guidelines set forth in the Financial Examiners Handbook of the National Association of Insurance Commissioners (NAIC), except where practices, procedures and applicable regulations of the Missouri Department of Insurance and statutes of the State of Missouri

prevailed.

## Comments-Previous Examination Report

The comments, recommendations, and notes of the previous examination report dated December 31, 1997, are listed below followed by the Company's response and the current examination findings regarding such comments, recommendations and notes.

**Comments-Previous Examination Report**

**Comment:** The Company requires one signature on checks issued. It was recommended that the Board review the Company's policy on issuance of checks to determine the level at which two signatures on checks should be required.

**Company Response:** The Company will review its policy regarding dual signatures on checks over a certain amount.

**Current Findings:** The Company has amended its check writing requirements and currently requires two authorized signors on checks in excess of $5,000.

**Comment**: The Company does not complete the reinsurance questionnaire to reflect the actual reinsurance in force. It was recommended that the reinsurance questionnaire be completed correctly.

**Company Response:** The Company will undertake a study to determine the mechanics and data necessary to complete the reinsurance questionnaire on reinsurance in force on the next annual insurance report filed with the Missouri Department of Insurance.

**Current Findings:** The Company currently completes the reinsurance questionnaire in a proper manner.

**Management and Control**

**Comment**: The Company has only elected six directors since 1994. The Articles of Incorporation state that the Company shall elect seven directors. It was recommended the Company elect a seventh director as provided by its Articles of Incorporation.

**Company Response:** The Board is taking measures to appoint a seventh director and should be completed by late summer 1998.

**Current Findings:** The Company complies with its Articles of Incorporation by maintaining seven members on the Board of Directors.

**Comment**: The Articles of Incorporation state the Company's officers shall consist of a President, a Vice President, a Treasurer, a Clerk of the Board, and a Secretary. The Company did not appoint a Clerk of the Board for any year during the period of this examination. It was recommended that the Company fill this position as provided by its Articles of Incorporation.

**Company Response:** The appointment of a Clerk of the Board will be addressed at the next Board meeting.

**Current Findings:** The Company appointed a Clerk of the Board during the current examination period, in accordance with the Articles of Incorporation.

**Conflict of Interest**

**Comment**: The Company could not produce conflict of interest statements for 1996. Company officials indicated that conflict of interest statements for this year were completed by all directors, but that they could not be located. It was recommended that conflict of interest statements be completed each year, and that the Company develop adequate record keeping procedures so that the statements can be retrieved.

**Company Response:** The record keeping and retrieval of these statements will be improved in the future.

**Current Findings:** Conflict of interest statements were executed by the Company's directors for all years under examination, and were made available for review.

**Corporate Records**

**Comment**: The Company could not locate its Bylaws. It was recommended that the current Bylaws be located, or if they cannot be located, that a set of Bylaws be drafted and approved at the next membership

meeting.

**Company Response:** An effort will be made to locate the Company's Bylaws and, in the event they cannot be located, the Board will see to it that a new set is prepared, approved, signed, filed and kept in a secure place.

**Current Findings:** The Company located its Bylaws, which were made available during the current examination.

**Accounts and Records**

**Comment**: It was found during the examination that certificates of deposit issued by Allegiant Bank in Warrenton, Missouri, with a total face value of $61,373, were missing from the Company's safe deposit box. It is recommended that the Company take actions necessary to replace these missing certificates of deposit. It is also recommended that the Company develop stronger controls to secure its investments and important corporate documents in the future.

**Company Response:** The missing certificates of deposit of $61,373 issued by Allegiant Band were reported to the issuer and duplicates have been received.

**Current Findings:** The Company has received replacements certificates for the missing items, and has instituted a receipt policy when certificates are removed from the safe deposit box.

**Comment**: It was recommended the Company review its certificates of deposit to determine whether it is necessary to change authorized signors.

**Company Response:** The signatory for all certificates of deposits and investments will be reviewed by the Company and appropriate authorized signors will be put in place.

**Current Findings:** The Company has updated is authorized signors as recommended.

**Real Estate**

**Comment**: The Company's investment in real estate exceeded the statutory limitation of $30,000 as prescribed by Missouri Regulation 20 CSR 200-12.020 (Approved investments). This regulation stipulates

that an investment in home office real estate shall not exceed the above limitation without prior approval from the Missouri Director of Insurance.

**Company Response:** The Company will request approval from the Missouri Director of Insurance for its 1998 report. If not granted, the Company will adhere to the $30,000 statutory amount.

**Current Findings:** The Company received approval from the Missouri Department of Insurance for the Company's investment in real estate on February 23, 2000.

**Guaranty Fund**

**Comment**: The Company should segregate its surplus into two categories. The Company should report the amount required by Section 380.271 RSMo (Guaranty fund required) of $218,954 as the "Guaranty Fund" on page one of its annual statement. Remaining surplus should be reported as "Other Surplus" for annual statement purposes.

**Company Response:** The Company will properly segregate surplus in future annual statements.

**Current Findings:** The Company segregated surplus between the guaranty fund and other surplus in the annual statements for the period under examination.

## HISTORY

**General**

The Company was originally organized on October 6, 1900 and incorporated on November 22, 1900, as Lincoln County Farmers Mutual Fire and Lightning Insurance Company. On January 22, 2000, the Company changed its name to Lincoln County Farmers Mutual Insurance. The Company operates under Sections 380.201 through 380.611 RSMo (Extended Missouri Mutual Companies).

**Management**

In accordance with the Articles of Incorporation, the annual meeting of the Company's members is

held on the first Saturday in March, at the home office of the Company or at such other place as may be designated by the management of the Company. Special meetings of the members may be called by the Board of Directors at any time and shall be called upon petition of one-fourth of the members. Membership meeting quorum requirements and proxy voting are not addressed in the Articles of Incorporation.

The management of the Company is vested in the Board of Directors, who are elected from the general membership. The Board of Directors consists of seven members, serving staggered, three-year terms. All directors must be policyholders of the Company. The Board of Directors meets approximately every month, and the directors are compensated $44 per meeting attended.

Members serving on the Board of Directors as of December 31, 2002, were as follows:

| Name and Address | Occupation | Term |
|---|---|---|
| Larry Black<br>2449 West Highway U<br>Hawk Point, Missouri | Retired Farmer | 2002-2005 |
| Frank W. Kadlec<br>484 Linns Mill Road<br>Troy, Missouri | Retired State Employee | 2000-2003 |
| Kenneth McDonald<br>377 Buck Creek Road<br>Silex, Missouri | Farmer | 2002-2005 |
| Charles Watson<br>955 Highway V<br>Troy, Missouri | Mutual Manager | 2000-2003 |
| Kenneth Hardy<br>27 Southgate Drive<br>Troy, Missouri | Retired Banker | 2001-2004 |
| Jim Mayes<br>174 New Hope Road<br>Elsberry, Missouri | Retired School Administrator | 2001-2004 |
| Harold Turnbull<br>251 Frenchman Bluff Road<br>Troy, Missouri | Retired Banker | 2001-2004 |

The Board of Directors elects for a term of one year a President, Vice-President, Secretary, Treasurer and Clerk of the Board.

The officers of the Company serving at December 31, 2002, were as follows:

| | |
|---|---|
| Frank Kadlec | President/Clerk of the Board |
| Harold Turnbull | Vice-President/Treasurer |
| Charles Watson | Secretary |

**Conflict of Interest**

The Company has written conflict of interest procedures for the disclosure of material conflicts of interest or affiliations by its directors and officers. The Company has its directors and officers sign conflict of interest statements on an annual basis, and no material potential conflicts were disclosed.

**Corporate Records**

A review was made of the Articles of Incorporation and the Bylaws of the Company. The Articles of Incorporation were amended on two occasions during the examination period.

On January 22, 2000, the Articles of Incorporation were amended to change the name of the Company to Lincoln County Farmers Mutual Insurance. On January 26, 2002, the Articles were amended to change the Company from an assessable to a non-assessable company and to change the date of the annual meeting from the Saturday nearest January 23$^{rd}$ to the first Saturday in March.

The minutes of the membership and the Board of Directors' meetings were reviewed for the period under examination. In addition, the Company's policies for investments and underwriting were reviewed. The minutes and records of the Company appear to properly reflect corporate transactions and events.

## FIDELITY BOND AND OTHER INSURANCE

The Company is a named insured on a fidelity bond providing a limit of liability of $50,000. The fidelity bond coverage meets the amount suggested in the guidelines promulgated by the NAIC, which is between $50,000 and $75,000 in coverage.

The Company carries directors' and officers' liability coverage with an annual aggregate limit of $1,000,000 and deductibles of $500 each loss, $2,500 in aggregate regarding directors and officers liability and a $5,000 regarding Company reimbursement.

The Company carries errors and omissions insurance for its agents with an annual aggregate limit of $500,000 and a deductible of $1,000 each loss.

The Company has business owner's coverage on its buildings and contents. The policy provides coverage of $85,000 on the building, $45,000 on personal property and $25,000 on electronic data processing equipment. The policy includes commercial liability coverage with an annual aggregate limit of $500,000 and medical expense limits of $5,000 per person.

The insurance coverage appears adequate.

## EMPLOYEE BENEFITS

The Company has three full-time and two part-time employees. The Company provides health insurance coverage and two weeks of paid vacation per year for full-time employees. It appears the Company has made adequate provisions in its financial statements for these benefit obligations.

## INSURANCE PRODUCTS AND RELATED PRACTICES

### Territory and Plan of Operation

The Company is licensed by the Missouri Department of Insurance as an Extended Missouri Mutual Company operating under Sections 380.201 through 380.611 RSMo. (Extended Missouri Mutual Companies). The Company is authorized to write fire, wind and liability insurance in all counties in the State of Missouri. The Company writes fire, wind and liability coverages.

The Company's policies are sold by 2 licensed agents, who are salaried employees of the Company. The Company does not have written agreements with its agents. It is recommended the Company execute

written agreements with its agents that include provisions regarding time limits for the delivery of fully completed applications to the home office and stipulate who is responsible for obtaining errors and omissions coverage for the agents.

**Policy Forms and Underwriting Practices**

The Company uses AAIS policy forms provided by the Missouri Association of Mutual Insurance Companies and policy forms provided by Grinnell Mutual Reinsurance Company, its reinsurer. The policies are renewed annually. Property inspections and adjusting functions are performed by in-house adjusters. Rates are determined by the Board of Directors. Renewal billings are mailed directly to the insured.

**GROWTH AND LOSS EXPERIENCE OF THE COMPANY**

| | Admitted Assets | Liabilities | Gross Assessment | Gross Losses | Investment Income | Underwriting Income | Net Income |
|---|---|---|---|---|---|---|---|
| 2002 | $1,560,564 | $162,645 | $949,915 | $443,138 | $60,182 | $(18,393) | $30,138 |
| 2001 | 1,412,610 | 44,827 | 927,008 | 501,266 | 72,639 | (54,439) | 11,530 |
| 2000 | 1,470,301 | 114,050 | 922,921 | 780,305 | 73,843 | 17,031 | 71,136 |
| 1999 | 1,390,419 | 105,303 | 863,376 | 644,261 | 45,300 | 42,080 | 89,759 |
| 1998 | 1,281,159 | 85,801 | 891,157 | 421,603 | 61,309 | 45,243 | 80,868 |

At year-end 2002, 2,093 policies were in force.

## REINSURANCE

### General

The Company's reinsurance premium activity on a direct-written, assumed and ceded basis for the period under examination is shown below:

| | 1998 | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|---|
| Direct | $874,246 | $848,990 | $903,590 | $907,603 | $931,220 |
| Assumed | 0 | 0 | 0 | 0 | 0 |
| Ceded | (391,836) | (394,653) | (103,266) | (236,568) | (272,663) |
| Net | $482,410 | $454,337 | $800,324 | $671,035 | $658,557 |

### Assumed

The Company does not reinsure other companies.

### Ceded

The Company has all of its reinsurance through Grinnell Mutual Reinsurance Company (the reinsurer). The reinsurance program consists of two per risk excess of loss, three aggregate excess of loss, and one facultative agreement for wind and fire risks and a quota share agreement for liability risks.

Under the first per risk excess of loss agreement, the Company retains $30,000 for any one risk any one occurrence, and the reinsurer is liable for the excess, limited to $50,000 with respect to any one risk, any one occurrence, and $150,000 in aggregate any one occurrence. The maximum individual risk to be ceded under the agreement is $500,000. Premium for the coverage is based on the four-year average loss ratio of the Company, with a minimum of 6.0% and a maximum of 14.0% of gross net written premium, and an annual minimum of $44,000. Under the second per risk excess of loss agreement, the reinsurer is liable for losses exceeding $80,000 any one loss, any one occurrence. The maximum liability assumed by the reinsurer is $420,000 any one risk, any one occurrence. Premium is equal to 2.5% of gross net written premium, subject to an annual minimum of $16,000.

Under the first aggregate excess of loss agreement, the reinsurer is liable for 97.5% of ultimate net losses exceeding 70% of the Company's net written premium. The reinsurer's annual liability is limited to 97.5% of 50.0% of the Company's net written premium. Premium is equal to 6.25% of the Company's net written premium, subject to an annual minimum of $38,000. Under the second aggregate excess of loss agreement, the reinsurer is liable for 100% of ultimate net losses exceeding 125% of the Company's net written premium. The reinsurer's annual liability is limited to 125% of the Company's net written premium. Premium is equal to 3.25% of the Company's net written premium, subject to an annual minimum of $20,000. Under the third aggregate excess of loss agreement, the reinsurer is liable for 100% of ultimate net losses exceeding 250% of the Company's net written premium. Premium is equal to 2% of the Company's net written premium, subject to an annual minimum of $10,000.

Under the property pro rata facultative agreement, the Company may cede risks to the reinsurer that exceed the individual risk limits outlined in the per risk excess of loss agreements. The reinsurer's liability is limited to $1,000,000 any one loss any one risk. The Company receives a 25% ceding commission on all risks ceded under the agreement.

Under the liability quota share agreement the Company cedes 100% of liability business to the reinsurer. The agreement limits policies to a $1,000,000 combined single limit and $10,000 medical payments. The Company receives a 25% ceding commission on all risks ceded under the agreement.

The Company is contingently liable for all reinsurance losses ceded to others. This contingent liability would become an actual liability in the event that any assuming reinsurer should fail to perform its obligations under its reinsurance agreement with the Company.

## ACCOUNTS AND RECORDS

The accounting records are maintained by the Company on a cash basis. The Company's CPA compiles the annual statement.

At December 31, 2002, the Company's cash and cash investment deposits in a financial institution exceeded FDIC insurance limits of $100,000 and were not otherwise insured. It is recommended the Company maintain cash and cash investment balances at or below FDIC insurance limits or obtain additional insurance on the deposits.

## FINANCIAL STATEMENTS

The following financial statements, with supporting exhibits, present the financial condition of the Company for the period ending December 31, 2002, and the results of operations for the year then ended. Any examination adjustments to the amounts reported in the Annual Statement and/or comments regarding such are made in the "Notes to the Financial Statements," which follow the Financial Statements. (The failure of any column of numbers to add to its respective total is due to rounding or truncation.)

There may have been differences found in the course of this examination, which are not shown in the "Notes to the Financial Statements." These differences were determined to be immaterial, concerning their effect on the financial statements. Therefore, they were communicated to the Company and noted in the workpapers for each individual annual statement item.

**ANALYSIS OF ASSETS**
**December 31, 2002**

| | |
|---|---|
| Bonds | $ 25,344 |
| Stocks | 157,146 |
| Real Estate | 46,258 |
| Cash on Deposit | 1,253,598 |
| Premium Receivable | 1,216 |
| Reinsurance Recoverable | 64,500 |
| Interest Due and Accrued | 10,753 |
| Furniture and Equipment | 1,749 |
| | --------------- |
| Total Assets | $1,560,564 |
| | ========== |

**LIABILITIES, SURPLUS AND OTHER FUNDS**
**December 31, 2002**

| | |
|---|---|
| Losses Unpaid | $ 112,900 |
| Ceded Reinsurance Payable | 23,600 |
| Unearned Premium (Note 1) | 329,279 |
| Payroll Taxes Payable | 4,185 |
| Accounts Payable | 19,022 |
| Federal Income Tax Payable | 2,938 |
| | --------------- |
| Total Liabilities | $ 491,924 |
| | --------------- |
| Guaranty Fund | $ 150,000 |
| Other Surplus | 918,640 |
| | -------------- |
| Total Surplus | $ 1,068,640 |
| | -------------- |
| Total Liabilities and Surplus | $ 1,560,564 |
| | ========== |

## STATEMENT OF INCOME
**December 31, 2002**

| | |
|---|---|
| Net Assessments | $ 658,557 |
| Reinsurance Commission | 255 |
| Net Losses Incurred | (361,298) |
| Other Underwriting Expenses | (315,907) |
| | ------------- |
| Net Underwriting Income (Loss) | $ (18,393) |
| | ------------- |
| Investment Income | $ 60,182 |
| Other Income | 3,884 |
| | ------------- |
| Gross Income | $ 45,673 |
| Federal Income Tax | (15,535) |
| | ------------- |
| Net Income (Loss) | $ 30,138 |
| | ======== |

## CAPITAL AND SURPLUS ACCOUNT
**December 31, 2002**

| | |
|---|---|
| Policyholders' Surplus, December 31, 2001 | $ 1,367,783 |
| Net Income (Loss) | 30,138 |
| Examination Change – Unearned Premium (Note 1) | (329,279) |
| | ------------- |
| Policyholders' Surplus, December 31, 2002 | $ 1,068,642 |
| | ======== |

## NOTES TO THE FINANCIAL STATEMENTS

Unearned Premium (Note 1) $329,279

The Company amended its Articles of Incorporation during 2002 to become a non-assessable Company, which collects premium rather than assessments. As such, the Company is governed under the provisions of Section 380.201 RSMo (Definitions), which requires the Company to maintain a reserve equal to the unearned portion of premiums written. The Company is directed to calculate and report the unearned portion of written premium on future annual statements.

## EXAMINATION CHANGES

| | | | |
|---|---|---|---|
| Total Policyholder's Surplus Per Company, December 31, 2002 | | | $1,397,919 |
| | Increase in Surplus | Decrease in Surplus | |
| Unearned Premium | $ 0 | $329,279 | |
| | ------------ | ------------ | |
| Total Change | $ 0 | $329,279 | (329,279) |
| Total Policyholder's Surplus Per Examination, December 31, 2002 | | | $1,068,642 |

## GENERAL COMMENTS AND RECOMMENDATIONS

Territory and Plan of Operation Page 12

It is recommended the Company execute written agreements with its agents that include provisions regarding time limits for the delivery of fully completed applications to the home office and stipulate who is responsible for obtaining errors and omissions coverage for the agents.

Accounts and Records Page 12

It is recommended the Company maintain cash and cash investment balances at or below FDIC insurance limits or obtain additional insurance on the deposits.

Notes to the Financial Statements – Unearned Premium Page 16

The Company does not currently report an unearned premium reserve. During 2002, the Company amended its Articles of Incorporation to become a non-assessable Company, which collects premium rather than assessments. As such, the Company is governed under the provisions of Section 380.201 RSMo (Definitions), which requires the Company to maintain a reserve equal to the unearned portion of premiums written. The Company is directed to calculate and report the unearned portion of written premium on future annual statements.

## SUBSEQUENT EVENTS

None.

## ACKNOWLEDGMENT

The assistance and cooperation extended by the employees of Lincoln County Farmers Mutual Insurance during the course of this examination is hereby acknowledged and appreciated.

## VERIFICATION

State of Missouri )
) ss
County of Cole )

I, Shannon W. Schmoeger on my oath swear that to the best of my knowledge and belief the above examination report is true and accurate and is comprised of only the facts appearing upon the books, records or other documents of the company, its agents or other persons examined or as ascertained from the testimony of its officers or agents or other persons examined concerning its affairs and such conclusions and recommendations as the examiners find reasonably warranted from the facts.

____________________________
Shannon W. Schmoeger, CFE
Financial Examiner
Missouri Department of Insurance

Sworn to and subscribed before me this ________ day of ___________, 2003.

My commission expires:

_____________________ ________________________________
Notary Public

## SUPERVISION

The examination process has been monitored and supervised by the undersigned. The examination report and supporting workpapers have been reviewed and approved. Compliance with NAIC procedures and guidelines as contained in the Financial Condition Examiners Handbook has been confirmed.

________________________________
Frederick G. Heese, CFE, CPA
Audit Manager – Kansas City
Missouri Department of Insurance